



**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TEGE EO Examinations Mail Stop 4920 DAL  
1100 Commerce St.  
Dallas, Texas 75242**

Release Number: 201623012  
Release Date: 6/3/2016  
UIL Code: 501.07-00

**Date: March 1, 2016**

**Taxpayer Identification Number:**

**Person to Contact:**

**Employee Identification Number:**

**Employee Telephone Number:**

**CERTIFIED MAIL – RETURN RECEIPT**

**Dear :**

**This is a final adverse determination regarding your exempt status under section 501(c)(7) of the Internal Revenue Code. Our favorable determination letter to you dated September 10, 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective September 1, 20XX.**

**The revocation of your exempt status was made for the following reason(s):**

**The nonmember income exceeded 15% of your total gross receipts for the years under examination. Further, you operated a business over at least years that was advertised to the public and accounted for a substantial part of your income. You failed the facts and circumstances test. A substantial percentage of your income was generated from business done with nonmembers. The use of your facilities by nonmembers was not infrequent. Your substantial business activities reflected that you were engaged in a business and were not operated exclusively for pleasure, recreation and other non-profitable purposes, and did not qualify for exempt status under section 501(a).**

**Also, you received nontraditional income from and parking spaces to members and nonmembers. The operation of a parking lot and office leases does not further pleasure, recreation, and other non-profitable purposes as described in IRC 501(c)(7). Leasing offices and parking spaces are prohibited nontraditional business activities because the services to members are neither related nor in furtherance of your exempt purpose. Exemption is denied unless the nontraditional activity is incidental, trivial, or nonrecurrent. Furthermore, the activity was not insubstantial, trivial or**



insubstantial, trivial or nonrecurrent because leasing offices and parking spaces were regularly carried on activities with increasing gross receipts. Your financial records show at least an annual increase in the monthly rates. The percentage of income you received from nontraditional activities in 20XX and 20XX is % and % respectively. Even if your income from leasing of offices and parking spaces is removed from the calculation of nonmember income for the years under examination, your percentage of gross receipts from nonmembership sources still exceeds the 15% and 35% limitations.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending August 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

You also have the right to contact the Office of the Taxpayer Advocate. The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Paul A. Marmolejo  
Acting Director, EO Examinations

Enclosures:  
Publication 892

**Department of the Treasury**  
**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations: Examinations  
300 North Los Angeles Street  
Los Angeles, CA 90012

Date: October 8, 2015

Taxpayer identification number:

Form:

Tax year(s) ended:

08/31/20XX; 08/31/20XX

Person to contact/ID number:

Contact numbers:

Manager's name/ID number:

Manager's contact number:

Response due date:

**Certified Mail – Return Receipt Requested**

Dear :

**Why you are receiving this letter**

Enclosed is a copy of our report of examination explaining why revocation of your organization's tax-exempt status is necessary.

**What you need to do if you agree**

If you agree with our findings, please sign the enclosed Form 6018-A, *Consent to Proposed Action*, and return it to the contact at the address listed above. We'll send you a final letter revoking your exempt status.

**If we don't hear from you**

If we don't hear from you within 30 calendar days from the date of this letter, we'll process your case based on the recommendations shown in the report of examination and this letter will become final.

**Effects of revocation**

In the event of revocation, you'll be required to file federal income tax returns for the tax year(s) shown above. File these returns with the contact at the address listed above within 30 calendar



days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

**What you need to do if you disagree with our findings**

If you disagree with our position, you may request a meeting or telephone conference with the supervisor of the contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information, including a statement of the facts, the applicable law and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

If you and Appeals don't agree on some or all of the issues after your Appeals conference, or if you don't request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court after satisfying procedural and jurisdictional requirements.

You may also request that we refer this matter for technical advice as explained in Publication 892. Please contact the person identified in the heading of this letter if you're considering requesting technical advice. If we send a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, then no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate Service (TAS). **TAS is your voice at the IRS. This service helps taxpayers whose problems with the IRS are causing financial difficulties; who have tried but haven't been able to resolve their problems with the IRS; and those who believe an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can call the toll-free number 1-877-777-4778 or TTY/TDD 1-800-829-4059. For more information, go to [www.irs.gov/advocate](http://www.irs.gov/advocate).** If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

If you have any questions, please call the contact at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.



Thank you for your cooperation.

Sincerely,

Margaret Von Lienen  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018-A  
Publication 892  
Publication 3498



Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>		Schedule number or exhibit
Name of taxpayer	Tax Identification Number		Year/Period ended 08/31/20XX 08/31/20XX

## **ISSUE**

- Whether the tax-exempt status of \_\_\_\_\_, a social club that has significant revenue from non-members, should be revoked.

## **FACTS**

The Club was recognized as exempt from federal income tax on September 10, 19XX. The Form 990, *Return of Organization Exempt from Income Tax*, fiscal year ending August 31, 20XX was filed with the Service on January 15, 20XX and showed the organization operates a \_\_\_\_\_. The Form 990, *Return of Organization Exempt from Income Tax*, fiscal year ending August 31, 20XX was filed with the Service on January 15, 20XX and showed the organization operates a social club. The Club's facilities consist of a \_\_\_\_\_ in the city of \_\_\_\_\_, \_\_\_\_\_ County. An audit of the Club's operations showed the Club is used for meals, meetings, and special events.

## **Operations**

The Club has the following regular operating hours:

The Club also opens before and after hours, and on weekends for scheduled member and non-member events and activities. The Club has Wi-Fi, internet, a business center, billiards room, and after hours bar available for use. The Club's \_\_\_\_\_ has a \_\_\_\_\_ for member only access on the back door that is accessible from its parking lot. The Club has two main front doors that are kept open during the day and do not limit access.

The Club leases \_\_\_\_\_ offices to \_\_\_\_\_ members and \_\_\_\_\_ nonmember indefinitely through month to month leases. The Club leases \_\_\_\_\_ parking spaces to \_\_\_\_\_ members and \_\_\_\_\_ nonmember indefinitely through month to month leases. All day parking around the area is limited and difficult to obtain. The parking space leases to members and nonmembers are non-traditional income.

The Club has a website at \_\_\_\_\_ that shows that the Club is available for ceremonies, special events, parties, business functions, meetings and \_\_\_\_\_. The Club also



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has a website at \_\_\_\_\_ that exclusively promotes its \_\_\_\_\_ as a \_\_\_\_\_ venue.  
The Club revised its \_\_\_\_\_ website in 20XX to include a link to its \_\_\_\_\_ website.

Additionally, the Club advertised and/or was featured as a \_\_\_\_\_ venue on other websites, such as \_\_\_\_\_, \_\_\_\_\_, in magazines such as \_\_\_\_\_, and at events such as \_\_\_\_\_. During the examination the Club provided a list of vendors that it advertised its \_\_\_\_\_ venue with. The general manager and sales director receive \_\_\_\_\_ % commission on event sales.

The Club's \_\_\_\_\_ also has rooms available for use by members and nonmembers on an hourly or daily basis. The Club allowed nonmembers to rent rooms with more than \_\_\_\_\_ persons in attendance and less than \_\_\_\_\_ % members for hourly and daily events.

The Club had approximately \_\_\_\_\_ hours of member use during the year ending August 31, 20XX. The Club had approximately \_\_\_\_\_ hours of nonmember use during the year ending August 31, 20XX. The Club was used a total of \_\_\_\_\_ member and nonmember hours. The nonmember use of the Club was \_\_\_\_\_ % of the total hours used ( \_\_\_\_\_ / \_\_\_\_\_ ). The Club Treasurer advised the Service that the Club's nonmember use was the same in 20XX. It was agreed the nonmember use in 20XX is also approximately \_\_\_\_\_ % of total hours used.

### Nontraditional Income and Gross Receipts Tests (Attachment A)

The Club provided a schedule of total nonmember events income from September 1, 20XX through July 31, 20XX that showed the event name and income per month. Based on the schedule of events from 20XX through 20XX and a review of the Club's books and records for the period ending August 31, 20XX and August 31, 20XX, the nontraditional income and gross receipts tests were performed. (See Attachment A.)

Activities that are not in furtherance of a social club's exempt purpose are referred to as nontraditional activities. The prohibition against nontraditional business activities applies equally to business with members and nonmembers. A social club is prohibited from conducting more than an insubstantial amount of nontraditional business activities. The percentage of income the Club received from nontraditional activities in 20XX and 20XX was \_\_\_\_\_ % and \_\_\_\_\_ % respectively. Nontraditional income was not included in the 15 or 35 percent allowances shown in Attachment A.

Even if the Club's income from the leasing of offices and parking spaces is removed from the calculation of nonmember income for the years under examination, the Club's percentage of gross receipts from nonmembership sources still exceed the 15% and 35% limitations. The Gross Receipts Test shows the percentage of income received from nonmember sources is \_\_\_\_\_ % in 20XX, \_\_\_\_\_ % in 20XX and \_\_\_\_\_ % in 20XX. Additionally, the Club projected similar substantial sales for 20XX and 20XX. (See Attachment A.)

New member initiation fees vary based on the type of membership category and range from \$ \_\_\_\_\_ to \$ \_\_\_\_\_. The Service did not request initiation fee amounts for years that were not examined.



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### Board Meeting Minutes Discussions

Board meeting minutes dated, September 12, 20XX showed an events discussion. A board member inquired if there was a way to understand profitability in advance of the event. A manager stated that there is analysis of every event and closer scrutiny to determine if parties are being charged enough for services.

Board meeting minutes dated Monday, April 29, 20XX showed the Club's accountants analyzed and discussed the Club's outside events and that the club is out of compliance with its 501(c) non-profit status. The accountants recommended the Club consider non-member income related to the Clubs 501(c) non-profit status.

Board meeting minutes dated, Monday June 10, 20XX shows the board added a bonus structure to the general manager's compensation package. The bonus was tied to increased membership numbers and club profitability.

Board meeting minutes dated, Monday, August 26, 20XX stated this is the out of the last years the Club has lost money.

Board meeting minutes dated, September 23, 20XX showed the organization began operating a designated phone line for the " " to help improve sales. Also, this was the best year for outside events at \$ and the coming fiscal year had \$ in event deposits for the upcoming fiscal year.

Manager's board report dated, March 24, 20XX showed outside events in the books with deposits for the year at \$ and \$ for the next year.

Board meeting minutes dated, Monday, June 30, 20XX showed the announcement of the new Director of Outside Sales & Events, who had already booked

Board meeting minutes dated Monday, July 28, 20XX Treasurer Report suggested that prices need to be more competitive with other venues to ensure all outside events are profitable. They also stated there was a % increase in outside events in the first fiscal quarter ( compared to events last year), because of marketing.

Board meeting minutes dated, Monday, August 25, 20XX showed that the organization brought in and almost spent , so they should raise pricing on and outside events. The staff needs to research the costs of competitors.

Board meeting minutes dated, Monday, November 24, 20XX showed that the Club approved landscape work to allow the Club to have a larger lawn and to book outside

### LAW

IRC § 501(c)(7) exempts from federal income tax clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and not part of the net earnings of which inures to the benefit of any private shareholder.



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Section 1.501(c)(7) of the Regulations provides that, in general, the exemption extends to social and recreation clubs supported solely by membership fees, dues and assessments. However, a club that engages in a business, such as making its social and recreational facilities open to the general public, is not organized and operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a).

Prior to its amendment in 1976, IRC § 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation and other nonprofitable purposes. Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow an IRC § 501(c)(7) organization to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. The Committee Reports for Public Law 94-568 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) further states;

(a) Within the 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as the latter do not represent more than 15 percent of total receipts. These percentages supersede those provided in Revenue Ruling 71-17, 1979-1 C.B. 683. A conclusion that there is a nonexempt purpose will be based on all the facts and circumstances including, but not limited to, the gross receipts factor.

IRC section 277 provides in the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. The deductions provided by sections 243 and 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year.

Treas. Reg. section 1.501(c)(7)-1(b) provides that a club which engages in business, such as making its social and recreational facilities available to the general public is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a).

Revenue Ruling 66-149 holds a social club as not exempt as an organization described in IRC § 501(c)(7) where it derives a substantial part of its income from non-member sources.

Rev. Rul. 68-168, 1968-1 C.B. 269 holds a nonprofit organization that leases building lots to its members on a long term basis is not exempt under IRC 501(c)(7). The revenues are not raised



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from the members' use of recreational facilities or in connection with the organization's recreational activities. The lease activities are not incidental to or in furtherance of social club purposes.

Rev. Rul. 69-220, 1969-1 C.B. 154 holds a social club that receives a substantial portion of its income from the rental of property and uses such income to defray operating expenses and to improve and expand its facilities is not exempt under IRC 501(c)(7).

Revenue Procedure 71-17 sets forth the guidelines for determining the effects of gross receipts derived from the general public's use of a social club's facilities on exemption under IRC § 501(c)(7). Rev. Proc. 71-17 describes the circumstances under which nonmembers who use a club's facilities will be assumed to be guests of members. The host-guest relationship will be presumed as follows, provided that payment is received directly from the member or the member's employer:

- A group of 8 or fewer individuals and at least one of the group is a member.
- An unlimited number of individuals and at least 75% of the group are members.

Where nonmember income from the usage exceeds the standard as outlined in this Revenue procedure, the conclusion reached is that there is a non-exempt purpose and operating in this manner jeopardizes the organization's exempt status.

The Court of Appeals has indicated some factors to consider in determining exempt status:

- The actual percentage of nonmember receipts and/or investment income
- Frequency of use of the club facilities or services by nonmembers
- Record of nonmember use over a period of years
- Purposes for which the club's facilities were made available to nonmembers
- Whether the nonmember income generates net profits for the organization.

(Pittsburgh Press Club v. USA, 536 F2d 572, (1976).

## **ISSUE # 1**

Whether the tax-exempt status of \_\_\_\_\_, a social club that has significant revenue from non-members, should be revoked.

## **TAXPAYER'S POSITION**

The Club agrees that the organization no longer qualifies for exempt status under IRC 501 (c)(7) and is considering whether they will sign Form 6018.

## **GOVERNMENT'S POSITION**

According to Section 1.501(c)(7) of the Regulations a club that engages in a business, such as making its social and recreational facilities open to the general public, is not organized and



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operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a).

The Club receives nontraditional income from leasing offices and parking spaces to members and nonmembers. The operation of a parking lot and office leases does not further pleasure, recreation, and other nonprofitable purposes as described in IRC 501(c)(7). Leasing offices and parking spaces are prohibited nontraditional business activity because the services to members are neither related nor in furtherance of the Club's exempt purpose. Exemption will be denied unless the nontraditional activity is incidental, trivial, or nonrecurrent.

Furthermore, the activity was not insubstantial, trivial or nonrecurrent because leasing offices and parking spaces are regularly carried on activities with increasing gross receipts. The Club's financial records show at least an increase in the monthly rates. The percentage of income the Club received from nontraditional activities in 20XX and 20XX is % and % respectively. Even if the Club's income from leasing of offices and parking spaces is removed from the calculation of nonmember income for the years under examination, the Club's percentage of gross receipts from nonmembership sources still exceeds the 15% and 35% limitations. (See Attachment A.)

The examination showed that the Club's income is a primary revenue maker. As such, the General Manager and Director of Outside Sales and Events actively seek outside events to be held at the Club and have a commission structure of percent to inspire profit making from outside events. Board meeting minutes also show that the Club's emphasis on profit making and enhancing the Club's beautification to increase event sales. The Gross Receipts Test showed that the Club had substantial income from nonmember events over at least a year period. The Club did not report any nonmember income or file a Form 990T for nonmember income. The Club's facilities are made available to the public on a regular and recurring basis and are in competition with for profit venues through regular advertising.

The Board meeting minutes also show that the Club was informed by its accountants that it was not in compliance with the nonmember income requirements of its 501(c) status. However, the Club continued to focus on and increase its nonmember income. The Club added bonus provisions to its managers' compensation that was tied to sales and profitability. The Club added a telephone line specifically for event sales and hired a new Director of Outside Sales & Events who was acknowledged for her sales ability. The Club monitored the nonmember sales and increased nonmember event rates based on its competition with for profit venues.

Additionally, The Court of Appeals in the Pittsburgh Press Club case showed factors to consider for a facts and circumstances test. The Club fails the facts and circumstances test for the following reasons:

Nonmember use of the Club was not infrequent. The record over a period of years shows substantial nonmember income. The Club was made available to nonmembers for special events and meetings as a business and in the same or similar manner as commercial venues that were



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open to the public. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Even when the Club did not show a profit on its nonmember activities, the addition of the website and designated phone line, advertising as a venue to the public through various channels, hiring of a Director of Outside Sales and Events, setting up a commission and bonus structure based on sales with its General Manager and Director of Outside Sales and Events, emphasis on sales and profitability and efforts to understand competition shows the Club was attempting to operate to make a profit from its nonmember income and did not have "substantially all" of its activities for "pleasure, recreation and other nonprofitable purposes" as required by section 501(c)(7).

Should the Club's tax exempt status be revoked IRC sec 277 applies. IRC sec 277 provides that nonexempt membership organizations are not allowed to offset losses from membership activities against income derived from investments or other nonmember sources to produce little or no taxable income.

## **CONCLUSION**

The IRC Section 501(c)(7) tax exempt status of the Club should be revoked since the nonmember income received by the Club exceeded 15% of the Club's total gross receipts for the years under examination. Further, the Club operated a venue business over at least years that was advertised to the public and accounted for a substantial part of its income. The Club fails the facts and circumstances test. A substantial percentage of the Club's income is generated from business done with nonmembers. The use of the club facilities by nonmembers is not infrequent. The Club's substantial business activities reflect that the Club is engaged in a business and is not operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a).